

United States Senate

WASHINGTON, DC 20510

August 26, 2004

The Honorable Roderick C. Paige
Secretary
United States Department of Education
400 Maryland Avenue, SW
Washington, DC 20202

Dear Mr. Secretary,

It has come to our attention that the Department of Education is allowing banks to exploit a loophole in the student loan program that will cost the nation's education budget nearly \$1 billion this year. This near \$1 billion should be used to increase Pell Grants or provide other urgently needed student aid—not increase the income of banks. We urge you to close this loophole right away.

The special subsidy involves a guaranteed 9.5 percent rate of return to banks on certain student loans directly or derivatively capitalized with the proceeds of tax-exempt securities. In 2001, the federal government spent approximately \$260 million to subsidize these 9.5 percent loans. This year, these subsidies are projected to cost almost \$1 billion.

In 1993, Congress passed legislation intended to begin the phase out of the 9.5 percent guaranteed return. Since 1993, however, through the refinancing of underlying tax-exempt securities, lenders have been able to recycle or roll over the 9.5 percent guarantee onto new loans to new students. But recently, the volume of 9.5 percent loans has not just been maintained through this mechanism. The Department has allowed the use of this loophole to grow, and students and taxpayers are paying the price.

No lender has been more aggressive in increasing its volume of 9.5 percent guaranteed loans than the Nelnet Corporation. Nelnet's 9.5 percent loans grew from \$447 million in March 2003 to \$3.4 billion in June 2004.

According to SEC filings, the Department of Education weighed in on the side of Nelnet and other student loan banks providing them with a financial boon using scarce federal education dollars. Previously, Nelnet refrained from declaring fully to its stockholders the 9.5 percent federal subsidy payments as corporate income. In Nelnet's July 2004 SEC filing, however, the company stated that it is now declaring fully all claimed and provided 9.5 loan federal subsidy payments "after consideration of certain clarifying information received in connection with the guidance it has sought and based on written and verbal communications with the Department of Education."

We believe that this is an important matter. Therefore, we respectfully ask the Department to provide our offices with all written correspondence and a summary of any verbal communication between the Department of Education and Nelnet specifically, and any other relevant major 9.5 percent loan holders, regarding growth in their portfolio of loans directly or derivatively financed with tax-exempt bonds. Please describe how in the aggregate lenders

suddenly are increasing their 9.5 percent loan volume after years of relative stability. Please provide all internal memoranda or other relevant documents, including draft audit letters, over the last three years discussing growth in 9.5% loans, their governing regulations, and governing policy.

In addition, we request answers to the following questions:

- * Did the Department approve of the methods that Nelnet and other lenders are using? If not, why hasn't the Department sought to recover illegitimately claimed subsidies?
- * If the basis for this is a regulatory ruling that pre-dates the Bush Administration, and the Administration disagrees with that ruling, why hasn't the Department changed it in light of the 1993 statutory change intended to limit the growth in 9.5% loans?
- * If the Department believes a statutory change is required to stop 9.5% loans, would the Administration support such a change being passed immediately with all savings dedicated to improving college access and affordability?

Mr. Secretary, at a time when middle class and needy families are confronting skyrocketing college costs, the federal government should be increasing financial aid to students, not banks. We believe this matter deserves prompt attention, and we look forward to your Department's urgent action.

Sincerely,



Senator Edward M. Kennedy
Ranking Member
Committee on Health, Education,
Labor, and Pensions



Congressman Dale E. Kildee
Ranking Member
Subcommittee on 21st Century
Competitiveness



Congressman Chris Van Hollen
Member
Committee on Education and Workforce

- cc: The Honorable Joshua B. Bolten, Director, Office of Management and Budget
The Honorable David M. Walker, Comptroller General, General Accountability Office
The Honorable Douglas Holtz-Eakin, Director, Congressional Budget Office
Mr. John P. Higgins, Jr., Inspector General, Department of Education